Expanding Business

- Area with growing demand
- Gross percentage is high
- Has assets which can be used to raise loans
- Increased sales may lead improve profit due to EOS
- Need to take advantage of the opportunity otherwise a competitor might

- Already has a lot of liabilities
- Loans are payable in current year, which may weaken liquidity
- Has no cash available due to overdraft
- Loans will be raised, incresing risk for partners
- Major risk that business may not expand to the extend expected
- Projections are only estimates
- Expenses will increase substantially
- Large loans may impact reputation of the business

IAS in the preparation of financial statements

- Provides a common international standard which can be applied across the world
- Skakeholders can rely upon the validity of figures in the statements
- Greater accuracy of reporting in statements prepared in the same format
- Enables comparisons to be made

- Only legally applies to corporate bodies
- Requires trained accounting staff
- Cost of implementation
- Non- financial factors are not included
- Standards can be contradictory

Concepts and Convetions

- Ensures consistency of approach when different businesses use the same concepts in preparing their financial statements
- Ensures greater accuracy when calculating profit
- Stakeholders can have trust and faith in the published financial statements of the business to be used for assessment
- Can be used for comparisons
- Statements are more understandable by the reader
- Concepts and conventions are the result of past experience and best practice
- Gives a true and fair view

- Are open to interpretations and used differently by each business
- Concepts may be contradictory
- Need to be skilled to implement
- Does not incorporate non financial factors

Depreciation

- Non current assets generally fall in value with age and usage
- The depreciation is a cost/ expense of a period of time and therefore should be charged against income for that period so that profit is not overstated
- Depreciation shows a value in the value of assets in the financial statements
- Caomplies with the going concern and accruals concept

Semi- Fixed

- Fixed over a limited range of output but once that limit is reached it increases bu then remain fixed over the next range of output

Semi- Variable

Includes both fixed and variable component. A fixed cost incurred if there is no output but variable component will increase directly with usage.

Variable Cost

- Cost varies directly with activity levels

Fixed Cost

- Fixed costs do not change with level of activity

Allocated overheads

- Are those costs which are directly relate to a department or cost centre therefore they can directly allocate to those specific departments or cost centres
- Costs which are wholly identifiable to one cost centre

Apportioned overheads

- Relate to atleast two or more cost centres, they must be apportioned on the most appropriate and reasonable basis.

Absorption of overheads

- A basis of recovering the total costs of a cost centre by the jobs that pass through them. This may be by a labour howur rate or machine hour rate
- The money charged for customer jobs, based on the calculated budgeted overhead absorption rate

Over absorption

- Workers worked more hours on productive work than planned
- Less overtime was worked than planned
- Actual overheads were lower than budgeted
- The total overhead cost must be charged to an individual cost unit

Under absorption

- Expenditure on overheads is greater than budgeted
- When the actual overheads are greater than the overhead recovered from chargeable work undertaken
- The actual hours worked was less that budgeted
- The non chargeable hours percentage was higher than budgeted

- Hours worked on recoverable work were less
- Low efficiency

Job costing

- Used where jobs are unique and to meet the specific order requirements of the customer.
- A system of costing that allocates and apportions costs to an individual customer order.

- Allows for calculation of profit earned on individual jobs
- Provides a basis for estimating costs for similar jobs in the future
- Provides a detailed analysis of all costs for each job
- Necessary for cost plus orders where price is worked out from cost

- Requires a great deal of administrative work to keep records of all transactions
- OAR are based on estimates so may lead to errors when quoting a price for the job
- Cannot be effectively operated without effective production control system and factory organisation
- The costs may be historic and out of data

The use of ICT accounting software

- Errors should be reduced because the software package determines and carries out the double entry for a given transaction
- It will be quicker
- Security would be improved as passwords would be required
- Less storage space required
- Standard reports can be extracted
- Audit trails can be kept

- The cost of hardware and software
- Training of staff will be required
- Security issues
- Risk of losing data

Using ICT to eliminate errors

- Errors reduced because the software will complete the double entry
- Eliminate arithmetical errors and ensure every debit has an equal value of credit
- The software will produce financial reports on a regular basis as required, therefore the construction and base data used will be correctly applied

- Although double entry will be completed with the debit and credit, the computer can only apply the figures supplied by the inputter. Errors from input
- Regular financial reports will require period end adjustments. If not accurately applied, the outcome will be inaccurate.

Lease or Buy

- No need for loan and the risk attached to it, inabilty to repay loan when the market is down
- No interest charge to impact upon profit. Removal of risk of interest rates
- Lower or no repair costs to air craft, borne by the lessor
- Cash flow smoothed as annul cost of lease matched to annual revenue
- Cash inflow from existing planes
- More projected profit using this method

- Leasing is a long term commitment
- Buy would lead to the business owning the asset, modify without asking for permission
- Can be rented or leased out
- Hire total costs are higher than purchasing
- Cash flow is more difficult to manage as there is an considerable expenditure at the start of the project

Bad debts vs provision of bad debt

- Only need to write entries as bad debt occurs. Fewer entries as there is no maintenance of an allowance of bad debts
- Actual bad debts known with precision and recorded when they occur
- No estimates or judgments will need to be made of potential debts. Recording of bad debts will be based on actual figures

- Accrual principal is not being applied. There is a requirement when preparing accounts to match with income.
- Prudent to allow doubtful debt which we know will occur but the extent to which is uncertain
- Profit for the year may be overstated because we are making an assumption that all debts will be realised through payment. Unrealistic to assume that all credit payments will be paid
- Business could be destablised by significant bad debt in the future, if planned beforehand through reviewing and projecting potential non payment then impact is lowered
- Cannot predict future bad debts with accuracy. Events will largely be out of our control for when a bad debts occurs

Non financial factors of a business

- Skill of workforce
- Quality and design of product
- Repuation/ image of business
- Location of premises
- Branding
- Relationship with suppliers
- Management
- Reputation

- Customer loyalty
- Competitive environment

Goodwill

- This is an intangible asset equal to the difference between the sale price of a business and the net value of the assets less liabilities
- It is not recorded as if it is difficult to value, can fluctuate, not prudent, money measurement concept.

When purchasing a business

- Gross margin
- Liqudity
- ROCE
- Inventory control
- Goodwill

Receipts and payments vs Income and expenditure

- Cash book of club
- Cash/bank payment summary
- Balance carried forward to next year's account
- Cash and payments unadjusted
- Only records non current assets when purchased or sold

- Income statement of a club
- Includes non cash items such as depreciation
- New account each year, no balance carried forward
- Establishes the surplus/deficit for a period
- Incomes/expenses adjusted for prepayments and accruals

Life Membership

- Postive initial cash flow, raising the cash balance
- Ties members to the club long term, more inclined to retain contact with the club long term
- May attract new customers because discount offered.
- The cash inflow can be used to pay back loan
- Probably reduces bad debts. Time saved chasing debts

- May not need cash payment in advance if it already has a surplus cash
- Creates long term liability to provide a service
- Probably delivered at a substantial discount, long term, ongoing, detrimental impact on future surpluses

Apportionment

- Overhead is divided on the most reasonable basis. The sales and purchasing manager will be responsible for the provision of services to a number of departments. There is a requirement to apportion this cost and the most reasonable basis for apportionment must be determined.
- A fair share of overheads is attached to each department. What amounts “fair” will depend on the apportionment method chosen
- The apportionment will be based upon cost driver for the overhead. The factor link the expenditure to the volume of use must be determined

- The divison of the cost is an estimate of use and not a precise calculation
- Apportionment can be an accurate calculation because there is a strong link between the cost and the driver. However the link can be arbitrary if the link between the cost and driver is not strong
- Cost may not be reduced if the department is removed or under performs.
- Requires considerable work to determine the basis of apportionment. Detailed consideration of the driving factors and collection of data will enable the apportionment to be completed will be required

Capital and Revenue Expenditure

- Capital expenditure is the acquisition of or enhancement of non- current assets which will provide a benefit to the business for more than one year
- Includes initial costs and upgrades to a non-current asset
- Spending to increase the value of a non-current asset
- One off purchase
- Intention to keep and use within the business
- Items appear in the statement of financial position under non current assets

- Revene expenditure is day to day expenditure, the benefit of which wil only be in the current year.
- It includes maintenance and repairs
- Including spending to maintain the value of the non-current asset
- They are usually recurring expenses
- Items such as inventory are purchased with the intention to sell and make profit
- It appears in the income statement under expenses

Moving from Straight to Reducing

- Staright line is simple to calculate, easier to use.
- Consistent to retain straight line method. Applying consistency method would be better to retain current method
- Equal usage each year. Equal amount of depreciation should be charged against income
- Time and skill required to restate previous year’s figures will take time and accounting skills

- Computers depreciate more than 10% per annum
- Computers tend to lose considerable value in the early year, understate dep using straight
- Carrying value will be higher in the early years, overvalue assets
- Applying method of prudence, the change in method is advised. Would ensure that depreciation would be appropriate to the value of teh non current asset

Straight line method

- Equal usage of non current assets from year to year to result in equal depreciation
- Applies accruals concept ensuring depreciation is matched to the period
- The application of the method does not distort profits

- Many non current assets market value depreciate heavily in the first year of ownership
- The market value may be different from the book value
- Total cost of ownership will increase when annual maintenance costs are added

Reducing balance method

- Greater dep in early years can reflect significant loss of value in early years
- Market value of asset can be more accurately reflected in the SOFP
- Over life of asset depreciation plus maintenance costs will even out, not distorting profits

- Can distort profit with high dep in early years
- Depreciation does not reflex, equal usage, equal cost over the years
- The change may break the consistency concept
- Still only an estimate.
- Does not take into account any residual value, assume the asset has an indefinite life

Admission of partner

- Additional capital will be brought into the business, expand and grow
- Work load shared by partners who will now have greater opportunity to specialise
- Cover for sickness/holidays.
- Shared risks as any losses will be shared between three partners
- More ideas

- Profits will need to be shared by the three partners instead of two, resulting in the requirement to increase profits to maintain income
- Extension of joint and several liability. The other partners will be liable for the actions of the new partner
- Decision making possible more complex as all partners will need consulting
- Disagreements can develop into serious disputes

Closure of a department

- Loss would be removed

- Space could be used to expand the other departments or create a new department
- Capital could be released from the department for general working capital or to fund the redevelopment of the space

- Most of the existing fixed costs will have to be borne by the other departments, therefore improvement in total profit may be minimal or non existent
- The department may stimulate sales
- Social accountancy factors of redundancy.

Day work

- Payment is made by a rate per hour* number of hours worked
- Workers are paid daily rate regardless of output produced
- Simple to calculate
- Quality provided as worker is not trying to meet  bonus targets
- Time spend with customers
- Enable to plan costs
- Absenteeism rate is minimised

- No employee incentive to increase productivity
- Rewards all employees equally, regardless of performance
- Supervision will be needed to ensure work is completed
- Inefficient working may require extra overtime working, adding to costs

Group Bonus Scheme

- Payment is made generally on a day work basis
- Plus a bonus generates by a group of workers divided by the number of workers
- Would encourage teamwork
- Would encourage greater efficiency of staff
- Cost of each job reduces
- Fixed overheads spread over more jobs
- Quick completion of jobs makes the business more competitive, gaining customers
- Bonus only has to be paid when production figures are high
- Less supervision may be needed

- Some workers may work harder than others which is unfair.
- Quality issues/ supervision required
- Possible reduction in customer service
- Slower workers may not be able to keep up and leave
- Workers may not work efficiently but instead make others do the job quickly
- Accidents may increase

Piece work

- Payment of wages is directly linked to output
- Output per operator would probably be increased and cost of a job decreased
- Workers may spend less time on non productive activities
- The more efficient, the more you earn

- Quality of output may be an issue
- Employee cannot plan their income and production issues will affect earnings
- There will be difficulty setting rates because all jobs are different
- Slower workers may not be able to keep up and leave
- Disagreements between workers may rise
- Accidents may increase
- More expensive to operate

Individual bonus scheme

- Workers may complete job in less time
- Labour cost for complete of each job will fall
- Workers may become more motivated
- Productivity will increase
- Meet social responsibility to adequately remunerate workers (minimum wage)

- Quality of work may fall as workers try to complete jobs in less time to earn bonus payments
- Teamwork may be reduced
- There is a greater risk for accidents
- Additional supervision may be required
- Difficult to establish bonus rate.

Social and ethical accounting

- Non financial factor
- Businesses should consider the effect of their decisions in a social/ ethical context
- Factors such as the local community, environment, health and safety or the use of natural resources, being honest, not misleading.

Trial Balance

- Gives prima facie evidence of correct posting. It is a checking device for the accuracy of the double entry.
- Financial statements can be prepared with certainty that the underpinning information is probably accurate

- Errors not affecting the balancing of the trial balance will not be revealed
- Time consuming to prepare

Mark up vs Margin

- Mark up percentage profit added to cost price
- Gross profit divided by cost of sales

- Margin is the percentage of profit contained within the revenue
- Gross profit dived by revenue

Capital vs Captial employed

- Capital is the net value that the owner has invested in the business
- Capital employed is the owners capital plus any non current liabilities borrowed to finance the business.

Double entry records/ Formal books of accounts

- Details of individual accounts will be available
- Financial statements can be prepared to ascertain profit on a regular basis
- Easier to make decisions because financial information is readily available
- 3rd parties such as banks can rely on information to grant loans

- Skill required to complete books of accounts
- Cost implications of eomploying a specialist. Time required by the owner.

Control Accounts

- Checking on accuracy of ledgers by ensuring that total of individual accounts in ledger equal to corresponding summarised enteries
- Can assist in locating errors when differences are discovered they are narrowed down to particular ledgers
- Total balances of trade receivables and payables available for owners to check and for immediate assistance in the preparation of financial statements
- Speeds up preparation of financial statements
- Helps reduce fraud as differences have a greater chance of being found with the separation of duties in posting the ledger
- Checks arithmetic accuracy

- Additional resources and time required to prepare
- Requries an experienced book keeper to prepare
- Not all errors will be revealed.

Liquidity

- Ability of a business to meet its short term debts. Failure to meet short term debts will result in delay to provide supplies Which the business can resell at a profit
- Could lead to bankruptcy.
- Need to have good cash flow to meet obligations
- Ability to covert inventory to cash in a short period of time
- Should be within range. Current ratio 1.4-2:1 and acid 0.7-1:1

Profitability

- Relates the gross profit or profit of the year to other figures within the same set of accounts
- The business' ability to generate profits
- Comparison with other figures could be to revenue or capital employed.

LIFO

- When prices are falling issues will be close to current replacement cost
- Products/sales will not be overpriced in current market conditions
- Closing inventory would be lower in times of inflation, lowering profits
- Inventory would be valued in the financial position statement at a value probably lower than the current replacement value.

- Not accepted by tax authorities or IAS
- When prices are falling remaining inventory will become increasingly overvalued
- LIFO may understate the cost of sales which is against the prudence concept
- If perpetual valuation used, considerable work involved in valuing inventory.
- During times of inflation, may lead to reduced asset value

FIFO

- More logical approach to inventory rotation in that you would look to sell your oldest inventory first.
- Yields higher profits when commodity prices are rising
- The value of inventory in the SOFP will be nearer to the replacement valuation
- Realistic as reflects physical movement of inventory
- Acceptable under IAS and tax authorities
- Easier to calculate

- Reverse case when commodity prices are falling
- The price of inventory issued to manufacturing is likely to be out of date so selling price might not reflect the most recent costs
- Might not conform to the prudence concept by increasing profit and asset valuation.

Draft financial statements

- Prepares draft financial figures for use
- Gives a reasonable estimate of profit
- Assits the making of decisions
- Easier to adjust draft statements to prepare final statements

- Reliance cannot be placed upon the information which is not accurate
- Work has to be repeated- time and cost
- Can lead to incorrect decisions

Continuing Manufacuturing

- Control of production process
- Quality is assured
- Social Accounting considerations
- Discontinuing could lead to redundancy and an impact on the local community
- Ensuring the continuity of supply of finished goods

- Fixed costs are shared between production and administration

- Problems of manufacturing will be dealt by the supplier
- Obtaining materials and quality labour is up to the supplier
- If manufacturing is discontinued, space could be used for distribution or sub let, costs reduced and incomes increased
- Time and effort of paying and managing staff and maintaining non current assets would be removed
- Manufacturing non current assets could be sold to release cash

Credit balance in trade receivables control account
- Customer over payment/twice
- Customer prepayment
- Goods returned after payment
- Error in recording
- Incorrect discount allowed calculated by customer

Reasons for overdraft
- Allowing too many days of credit to trade receivables
- Paying trade payables too quickly
- High drawings
- Inadequate capital for business growth
- Expenses too high
- Selling price too low
- Inventory to high
- Purchases of non-current assets

Bad debt and provision of bad debts
- Actual bad debts from the last period
- Actual figure
- Expense of the period entered in the income statement
- These have occurred in the current period

- Estimate of the possible bad debts in the next period
- Estimate only
- Application of prudence concept to value trade receivables accurately
- This is for a debt which might occur in a future period

Social accounting vs Ethical Accounting
- Business should consider their actions in a social context and not just profit
- Considers impact on workers, community and environment, health and safety and natural resources
- Long term benefit for business and society

- Set of moral values and principles

- Business should report with honesty
- Not misleading by issuing incorrect statements or financial statements
- Not withholding relevant information
- There is a code of ethics
- Ethics begins where the law ends
- Social and moral aspects
- Honesty and trustworthiness
- Prevent fraud and corruption
- True and fair view of the business

Ratios

- Provide a yard stick to measure against liquidity ratios, profitability and use of assets
- Provide a basis for comparison with previous performance/competitiors
- Compare ROCE to alternative investments
- Accepted measures can be applied
- Uses by external users that do not want detailed information]
- Help forecast future business performance.
- Level of expertise required

- Does not consider non financial factors
- Always analysing historical data
- Seasonal differences can distort results
- Comparing different businesses can be problematic
- Different ways to value inventory
- The existence of direct comparators

Partnership agreement

- Clear about the terms of their partnership relationship
- This clarity should avoid disagreements or understanding in the future

- If it is formalised, takes time and money
- No agreement can cater for all eventualities that the partnership will face

Good credit control

- Before supplying goods on credit, a credit worthiness check should be made of the buyer
- A credit limit should be set based upon the buyer's credit worthiness
- Goods should be promptly invoiced
- Statements should be provided on a monthly basis
- Unpaid debts should be followed up after one month of outstanding
- Constant monitoring of aged debts wiht personal contact, where debts are two months old
- Restriction of further credit where debts remain unpaid for well over a month
- Legal intervention only if debt is circa three months old and no movement towards payment

Inventory Valuation

- Inventory must be valued at cost and made using assumptions of value using the FIFO or LIFO method.

Inventory rotation

- Relates to the physical movement of inventory being received and issued from the stores. In this respect a business will generally issue it's oldest inventory first to avoid detoriation and obsolescence.

Perpetual vs Periodic

- Perpetual will allow valuation method to issue inventory at prices which vary to each issue made in line with chosen method chosen
- Periodic could result in issue prices which do not reflect the replacement cost when prices are rising or falling rapidly

- Periodic is a simpler approach because issue prices will be constant for a period.
- Issue costs will not be changing everyday

Full accounting records

- Running balance in accounts such as Quality Catering
- Queries about account balances can be discussed with reference to the account
- Statements of account can be sent out each month
- The existence of errors can be identified by a trial balance
- Financial statements can be prepared at regular intervals and profit ascertained
- Establish expenditure to control costs
- Manage business more effectively
- Form of basis for government or banks

No partnership agreement

- Loan: 5%
- Salary: None
- Interest on drawings: None
- Interest on capital: None
- Share of profit: Equal shares

Projections

- Target to work for in the coming year/ motivation
- Aid in decision making
- Projection of costs can aid in control of costs
- Gives idea of future profits
- Provides a strategy for next year
- Can help to manage the business
- Set goals for the business

- Projection are only estimates of what might happen and may be inaccurate
- There are certain events that cannot be predicted
- Investment decisions may be made in advance which are then not supported by increased revenue
- Takes time and distracts managers from other tasks
- Expertise to prepare accurate budgets

Reasons for revaluation method

- Many small items which are difficult to count and value
- Possibility of major fluctuations in value
- Book value matches market value/more accurate

- Valuation is just a judgement and difficult to get accurate
- Considerable work in revaluing non current assets every year
- Requires input from specialist valuers
- Can distort profits as valuations fluctuate
- Historic cost concept comes into question
- Usually use for small items only

Labour Productivity

- Is the relationship between inputs used and the outputs gained usually expressed as output/units per hour/day

Activities that cannot be directly chargeable

- Travelling to jobs
- Ordering or collecting materials
- Completing paperwork
- Training
- Remedial work for jobs not completed correctly

Decision only based on profit

- Profit is the main driver to reward entrepreneurship
- Business must make sufficient profit to pay costs and replace non current assets
- Maximising profit may lead to efficient control of assets
- Profit ensures that the business is a going concern

- Wider factors such as the business impact on workers, society and environment should be made
- Which may increase motivation of workforce
- Increase brand value
- Ethical issue should also be considered such as selling dangerous goods
- Some organisations are non profit making such as clubs and societies

Transfer value of product to finished goods from cost plus to fixed price for each unit

- Cost plus is easy to calculate
- Transfer cost per unit can be compared with purchase from an external source
- Complies with consistency concept as this method is currently being used

- Fixed price per unit can measure efficiency accurately
- Rate can be set at market/purchase price
- Gives managers a clear target to achieve

Setoff (contra entry)
- When a business is a supplier and customer. The balance is set off and therefore only one settlement cheque is required.

Fixed capital vs floating capital
- Unless there is withdrawal or introduction of capital, the balance remains the same
- Capital can only be withdrawn by the agreement of partners
- Easier to calculate interest on capital

- Capital varies for profit and drawings
- Capital can be withdrawn in the form of drawings
- Complex to calculate interest on drawings
- Partners personal transactions are in a single account, so a single point of reference for personal information
- A single account giving each of the partners investment in the partnership

Selling for cash only
- Improves cash flow
- Eliminates bad debts
- Less bookkeeping
- No cash discounts given
- No credit control needed

- Not everybody has cash to purchase
- Customers will go to rival sellers
- Competitors will be able to grow their business
- Security issues with a large amount of cash
- Possibility of fraud

Provision of unrealised profit
- To ensure profit is not overstated by recording profit on unsold inventory
- Inventory is not overvalued by deducting the value of provision from the inventory in the SOFP

Trade discount vs cash discount
- Gien to other traders who are significant customers to enable them to make a profit
- Not written in the ledger books of accounts

- Given to encourage prompt payment
- Recorded in the books of accounts

Roles of accountants
- Recording
- Analysing

- Communication

Going concern
- This refers to a business that will continue its operation for the unforeseeable future.
- Not going to stop trading
- Depreciation

Consistency
- Treatment of similar items in the same way
- Depreciation
- Allowed to change if it provides a true and fair view of the business

Prudence
- Assets and incomes are not overstated and liabilities and expenses are not understated.
- Provision of debts/unrealised profit

Accruals
- Revenue earned in the an accounting period should be matched against the expenses involved in earning those revenues
- Only write expenses and revenue that are incurred in the current year

Historic Cost
- Ensures the cost of an asset is a known fact and can be verified, costs are written at original cost instead of market value
- Not always applied for revaluation method and property

Money Measurement
- Items are only shown in the accounts if they have monetary value.
- Cannot include things like goodwill and quality of goods

Business entity
- Financial affairs of the business should be separate from the financial affairs of the owners.
- Good taken from business is considered as drawings

Materiality
- Only material items (those that can influence decision making) are written in the statement of financial position. Small items are considered as a revenue expenditure even though they might stay in the business for long time

Realisation
- Revenue should only be recognised when the exchange of goods and services are certain and do not anticipate sales.

Types of errors
- Commission: Correct class but wrong account of that class (no effect)

- Omission: Transaction has not been entered into the ledger (no effect)
- Principal: Incorrect class of account (affects both)
- Reversal: where debit is written as credit and vice versa (may be affected)
- Original entry: Where the wrong amount is entered (affected both)
- Compensating: Two separate have the effect of cancelling each other out (may be affected)

Net reasonable value

- Inventory valuation based on the selling price less any additional costs required to affect the sale

Factory Profit

- The approximate profit added to the production cost of goods completed to arrive at the transfer price.
- Allows the business to identity the profits made by different cost centres
- It allows a comparison to be made directly with possible suppliers of the prices and the price could include an element of profit
- Manufactacturing profit is separated from the trading operations of the business

- Profit levels are probably not set with any degree of accuracy
- The profit should equate to the profit earned by possible suppliers and this is not possible
- Over profit is no different, so might be a waste of resources